

BEFORE
THE PUBLIC SERVICE COMMISSION
OF SOUTH CAROLINA
DOCKET NO. 2014-346-WS

IN RE:	Application of Daufuskie Island Utility Company, Incorporated for Approval of an Increase for Water and Sewer Rates, Terms and Conditions)))))	ORS ANSWER TO DIUC PETITION FOR RECONSIDERATION AND/OR REHEARING
--------	---	-----------	---

The South Carolina Office of Regulatory Staff (“ORS”) respectfully submits this Answer pursuant to S.C. Code Ann. Regs. 103-826 (2012) to the Daufuskie Island Utility Company, Inc. (“DIUC” or the “Company”) Petition for Reconsideration and/or Rehearing (“Petition”) of Public Service Commission of South Carolina (“Commission”) Order No. 2018-68 issued on January 31, 2018. ORS asserts that the Commission’s Order is just, fair, and supported by substantial evidence and that the Commission should not replace the Commission’s Order with DIUC’s Proposed Order in its entirety, nor should the Commission revise its Order to achieve DIUC’s original 108.9% requested rate increase.

Rate Base/Utility Plant in Service

ORS provided substantial evidence such that the Commission’s decision to adopt ORS’s rate base adjustments was appropriate. ORS witness Gearhart testified that ORS’s review of the Company’s rate base consisted of three steps: 1) verifying the Company’s rate base, reported by DIUC in its Application, was supported by DIUC’s accounting books and records for the twelve months ending December 31, 2014 (“test year”); 2) testing the underlying transactions in the books and records for the test year to ensure the underlying transactions in the books in the records were adequately supported, had a stated business purpose, were allowable for ratemaking purposes, and were properly recorded, and; 3) making necessary adjustments to revenues, expenditures, and capital investments to normalize the Company’s operating experience and rate base, in accordance with generally accepted regulatory principles and prior Commission

orders. (Hearing Tr. P. 489, ll. 7-17). Additionally, ORS witness Sullivan adopted the pre-filed testimony as filed by ORS witness Gearhart. (Re-hearing Tr. P. 438, ll. 15-22). ORS witness Sullivan testified that upon ORS review of South Carolina Supreme Court Opinion No. 27729 (the “Opinion”), ORS determined it should recommend adjustments to plant-in-service.¹ (Re-hearing Tr. P. 235, ll. 11-12). According to ORS witness Sullivan,

[b]ased on guidance from [the Opinion], ORS proposes to adjust gross plant in service to include the water tank and well located on the elevated tank site. In Docket No. 2011-229-WS, ORS removed \$863,379 from plant in service for the elevated water storage tank and \$61,956 for a well located on the elevated tank site due to ownership disputes The ORS adjustment to plant in service on Audit Exhibit ICG-4 was (\$1,624,696). Based on the Supreme Court guidance, ORS now computes an adjustment to gross plant in service of (\$699,361) which is shown on Revised Rehearing Audit Exhibit DFS-5. Audit Exhibit ICG-5 showed the adjusted water total for reservoirs and standpipes as \$34,700. Revised Rehearing Audit Exhibit DFS-5 includes the elevated water storage tank amount of \$863,379, and shows the adjusted water total for reservoirs and standpipes as \$898,079. Audit Exhibit ICG-5 showed the adjusted water total for wells as \$732,908. Revised Rehearing Audit Exhibit DFS-5 includes the \$61,956 for the well removed in Docket No. 2011-229-WS and shows the adjusted water total for wells as \$794,864. Revised Rehearing Audit Exhibit DFS-5 reflects all other adjustments to plant-in-service included on Audit Exhibit ICG-5.

(Re-hearing Tr. P. 451, ll. 12-23, p. 452, ll. 1-4).

Rehearing Exhibit 8, prepared by ORS witness Sullivan, specifically itemizes the amounts and corresponding plant. As a result of the testimony and exhibits presented by ORS witnesses Gearhart and Sullivan, ORS asserts that the Order cites sufficient evidence to support ORS’s recommended adjustment of \$699,361.

Additionally, ORS takes numerous steps to give applicant utilities reasonable opportunities to gain a better understanding of ORS’s adjustments, should it wish it, outside of an adversarial setting. For instance, ORS conducts “exit conferences” with applicant utilities where it reviews all adjustments in an open and transparent manner. (Re-hearing Tr. P. 487, ll. 1-3 and again, tr. P. 521, ll. 11-14.) DIUC witness Guastella admitted that during and after these exit conferences ORS worked with the Company to identify

¹ The Opinion gave ORS guidance regarding adjustments to the existing plant-in-service, property tax, and bad debt adjustments. Additionally, the Opinion specifically allowed for new evidence to be presented regarding rate case expenses.

the specifics of ORS's adjustments, "ORS provided DIUC with work papers as a follow up to our audit exit conference call that enable us to identify what we think are the specifics of its adjustments." (Hearing Tr. P. 202, ll. 21-23). Finally, DIUC had the opportunity to cross examine ORS witness Gearhart and ORS witness Sullivan regarding the specific nature of any adjustment recommended by the ORS. DIUC made this very same argument in its original Petition for Rehearing. If DIUC believed that ORS witness Gearhart's testimony lacked detail, it had the opportunity to question ORS witness Sullivan. The Commission denied DIUC's previous Petition for Rehearing that DIUC filed with this Commission on December 21, 2015, where DIUC made this same argument, and it should be denied here as well.

ORS properly recommended adjustments to booked values on which DIUC could not provide verification and the Commission appropriately accepted these adjustments. According to ORS witness Gearhart, the purpose of her audit review was to test the underlying transactions that are recorded on the books. (Hearing Tr. P. 489, ll. 7-17). When a booked item cannot be verified based on the information provided by an applicant utility, it is job of the ORS auditor to recommend an adjustment corresponding to the undocumented expense. (Id.) DIUC witnesses Guastella and White ascertain that because an item exists, ORS should allow the item into rate base at amount determined by the utility. (Hearing Tr. Pp. 203-204 and Re-hearing Tr. P. 183, ll. 13-15). Booked items that cannot be verified should not be passed on to ratepayers. Accordingly, the Commission should not require that these costs be passed on to ratepayers. The Commission Order properly excluded rate base item expenses on which the Company failed to provide supporting evidence to either ORS or the Commission.

The evidence presented by ORS supports the adjustment made for capital costs and legal costs associated with plant in service (i.e. the "Land and Land Rights" as shown in Exhibit DFS-5). According to both ORS witness Sullivan and ORS witness Gearhart, ORS reviewed the general ledger provided by the Company and calculated depreciation expense as of December 31, 2014. (tr. P. 461.)

Finally, based on the Supreme Court's Opinion, previous discussions with all parties, DIUC's letter filed on October 4, 2017,² and DIUC's requested abbreviated proceeding,³ ORS incorporated the guidance from the Supreme Court's Opinion into its previously proffered adjustments, and reviewed any new evidence presented by DIUC. ORS did not revisit previously reviewed issues not addressed by the Supreme Court.

Accumulated Depreciation and Depreciation Expense

ORS presented substantial evidence on which the Commission relied when it accepted ORS's adjustments regarding accumulated depreciation and depreciation expenses. According to ORS witness Sullivan,

...through discovery, DIUC submitted invoices to support additional rate case expenses that had been incurred since the original October 20, 2015, Commission hearing. Based on a review of the invoices provided by the Company, ORS updated total rate case expenses and the amortization of rate case expenses. ORS also updated all "fall-out" adjustments such as depreciation expense, accumulated depreciation ... ORS prepared Rehearing Audit Exhibits DFS-1 through DFS-8 based on these changes and using the Company's proposed increase in its rehearing testimony and exhibits.

(Tr. P. 444, ll. 13-22).

Fall-out adjustments depend upon other adjustments for their determination. Therefore, pursuant to DIUC's interpretation of the Court's Order, and the Court's Order itself, any new fall-out adjustment would only occur in the re-hearing to the extent it, or an adjustment upstream, was required by the Court's guidance or new evidence dealing with the pendency of an appeal is presented by DIUC.⁴ ORS followed the guidance given by the Supreme Court and provided evidence to that effect. A mere conflict between two sets of evidence does not prove that one set is not substantial. Rather, the Commission acts as the trier of fact, weighs the evidence before it, and makes its determination. *See S. Bell Tel. & Tel. Co. v. Pub. Serv. Com.*, 270 S.C. 590, 597, 244 S.E.2d 278,

² Wherein DIUC stated that the Supreme Court intended to limit the "multiple adjustments" to property taxes, plant in service, bad debts, managements fees, and rate case expenses.

³ DIUC requested and received an abbreviated proceeding because of its difficulties in continuing its appeal bond after the end of 2017. (*See* Commission Order No. 2017-61-H).

⁴ *See* Supreme Court Opinion footnote 8.

282 (1978). The Commission appropriately weighed the evidence and relied on substantial evidence in making its decision to accept the ORS recommended accumulated depreciation and depreciation expenses. As a result, the Petitioner's request should be denied.

Rate Case Expense

The Commission's Order properly excluded \$542,978 of Guastella Associates' ("GA") invoices⁵ as recommended by ORS, and the Commission properly applied the Supreme Court Opinion. ORS incorporated the guidance given by the Supreme Court.⁶ ORS witness Hipp,

"adopt[ed] the direct testimony and exhibits of Willie J. Morgan filed on October 2, 2015, and re-affirmed[ed] the positions taken by ORS witness Morgan during the October 28, 2015, hearing with the exception of any changes made to comply with the South Carolina Supreme Court Opinion No. 27729, issued on November 15, 2017, or resulting from new evidence presented by [the Company]."

(Re-Hearing Tr. P. 472, ll. 9-14).

ORS asserts the Commission afforded DIUC the ability to rebut testimony and exhibits, which recommended an adjustment to certain DIUC rate case expenses. The Petitioner asserts that "prior to the filing of ORS surrebuttal re-hearing testimony, there was never any testimony in this case about ORS concerns as to the format of GA invoices or that it was discussed with DIUC." However, pursuant to ORS witness Hipp's rehearing direct testimony, filed on November 16, 2017,

ORS applied the following criteria to ensure the DIUC invoices and supporting documentation included for ratemaking meet "known and measurable" standards: 1) The invoice is mathematically correct; 2) The invoice is for a valid business purpose; 3) The expense was incurred during the period under review; 4) The invoice was properly recorded on the books and records of the Company; and 5) The invoice was paid by the Company.

(Re-hearing Tr. P. 474, ll. 7-15).⁷

⁵ The majority of ORS's recommended adjustments to rate case expenses correspond to GA expenses. (See Tr. Pp. 475, ll. 1-22 and 476 ll. 1-18.)

⁶ In its Order, the Supreme Court specifically gave guidance on only 3 issues: the rate base includes the elevated tank site; property tax expense; and the bad debt expense. The Order also recognized that because rate cases are heavily depending upon factors subject to change during the pendency of an appeal and new economic realities may arise during the appeal, new evidence may be presented.

⁷ ORS witness Hipp's direct testimony was filed on November 16, 2017; however, it was revised on November 29, 2017, to correct an error regarding Supreme Court ordered bond premium costs.

Therefore, DIUC had the opportunity to respond to ORS's testimony and exhibits through its rebuttal testimony and exhibits.⁸ Furthermore, because these criteria outlined and applied to rate case expenses for which the Company sought recovery based on "new evidence," ORS's direct testimony on re-hearing was the earliest testimony ORS could have filed regarding these rate case expenses. Contrary to DIUC's assertions, ORS witness Hipp's testimony is both timely and fair because ORS witness Hipp raised these issues in her direct testimony, thereby giving the Company an opportunity to respond in its rebuttal testimony.

DIUC also asserts that it was not afforded a fair opportunity to rebut ORS witness Hipp's testimony because, according to DIUC, ORS treated DIUC in an unfair manner by "not allow[ing] DIUC to provide additional information...." DIUC never provided additional information or offered additional information, despite opportunities.⁹

The Commission's denial of unsupported expenses is a justifiable measure and not punitive. ORS witness Hipp testified that the rate case expenses for which DIUC seeks recovery "do not meet the criteria that the NARUC Chart of Accounts requires for record-keeping, and nor do they conform to the guidance that NARUC lays out when it sets out its auditing protocol for different regulators to follow." (Re-hearing Tr. P. 502, ll. 14-19). If DIUC's request for recovery of these rate case expenses were granted, ratepayers would be required to pay for expenses that are not known and measurable. ORS believes the Order is not meant to punish DIUC. The Order ensures fair recovery where due because the Commission has allowed DIUC the opportunity to recover supported rate case expenses in a future rate case proceeding provided DIUC can show supporting information that satisfy the criteria listed by ORS witness Hipp.

⁸ It is also not unusual for an applicant utility to request and receive permission to update rate case expenses at the hearing, which began on December 6, 2017.

⁹ DIUC's requested abbreviated proceeding left ORS little time in which to review nearly \$800,000 in additional rate case expenses. While ORS asserts DIUC received no unfair treatment, if DIUC believes it incurred any hardship resulting from this condensed schedule, it is self-imposed.

As set forth in Rehearing Exhibit 10, ORS witness Hipp outlined the invoice deficiencies that demonstrate why certain invoices were found not to be known and measurable.¹⁰ While DIUC may be entitled to the presumption that its expenditures were reasonable and incurred in good faith, that presumption does not foreclose scrutiny and a challenge. *See Utils. Servs. of S.C. v. S.C. Office of Regulatory Staff*, 392 S.C. 96, 109, 708 S.E.2d 755, 762 (2011). GA is responsible for preparing and filing the rate case and manages day-to-day operations. (Re-hearing Tr. P. 486, ll. 5-8). Also, DIUC witness Guastella testified that he “tell[s] [Terry Lee] what to do” and that “[DIUC witness Guastella] report[s] to Mr. Lee.”¹¹ (Re-hearing Tr. P. 205, l. 23, and Tr. P. 206, l. 10). DIUC witness Guastella’s testimony raises the specter that he may be on both sides of the negotiated table, thus further necessitating a scrutinizing review of GA expenses. *See Hilton Head Plantation Utils. v. Pub. Serv. Comm’n*, 312 S.C. 448, 441, 451 S.E.2d 321, 323 (1994). Once expenses are challenged, the burden remains on the utility to demonstrate the reasonableness of its costs. *Utils. Servs. of S.C. v. S.C. Office of Regulatory Staff* at 109, 762. DIUC had opportunities to demonstrate the reasonableness of these costs but did not, and unsubstantiated expenses by a regulated utility should not be borne by its ratepayers.

Finally, the Petition alludes frequently to the “ample time” provided to ORS throughout this process. There is typically 6 months from the date an application is accepted to the date the Commission issues an Order.¹² Due to DIUC’s request for and receipt of a condensed schedule, ORS was required to review new information, the acceptance of which would incur expense to ratepayers, in a much shorter time provided in a typical rate case. The new rate case expenses, for which ORS recommended an adjustment, were not provided by DIUC to ORS until the end of October and

¹⁰ Additionally, the actual invoices are included in Rehearing Exhibit 9, DMH-1.

¹¹ DIUC witness Guastella is the president of GA. (Re-hearing Tr. P. 173, ll. 16-18). Terry Lee is president of DIUC. (*Id.*)

¹² *See* S.C. Code Ann. 58-5-240(C).

because of DIUC's condensed schedule, ORS had a little over two weeks to conduct a review and verification of DIUC's responses and draft testimony regarding these expenses.¹³

The Petition claims that DIUC was unfairly treated by ORS because there was not a "back and forth" dialogue. This characterization is untrue. As a result of Petitioner's requested schedule, there simply was not time to have as much dialogue as occurs in a normal rate case period of 6 months. Without documentation that the costs to be passed on to ratepayers are known and measurable, ratepayers should not bear those costs. Therefore, ORS respectfully submits that the Commission's Order resolves the issue by allowing DIUC to recover rate case expenses in future rate cases to the extent the Petitioner can show them to be known and measurable.¹⁴

Conclusion

ORS supports Commission Order 2018-68, which is supported by substantial evidence contained in the record. As a result, ORS respectfully requests that DIUC's Petition for Reconsideration be denied.



Andrew M. Bateman, Esquire
 Jeffrey M. Nelson, Esquire
 Shannon Bowyer Hudson, Esquire
 SOUTH CAROLINA
 OFFICE OF REGULATORY STAFF
 1401 Main Street, Suite 900
 Columbia, South Carolina 29201
 Phone: (803) 737-8440
 (803) 737-0889
 (803) 737-0823
 Fax: (803) 737-0895
 E-mail: abateman@regstaff.sc.gov
 jnelson@regstaff.sc.gov
 shudson@regstaff.sc.gov

March 13, 2018
 Columbia, South Carolina

¹³ ORS objects to DIUC's characterization that ORS's adjustments with regards to unverified expenses constitutes a "gotcha" position. The burden rests with the applicant utility to provide supporting documentation for expenses.

¹⁴ Petitioner asserts that the Commission should allow DIUC to recover the costs for "at least one-half of the rate case" work. However, the Petitioner has not shown that "at least one-half" of the costs sought are known and measurable. Choosing an arbitrary number is not substantial evidence, nor would "at least one-half" of these rate case expenses constitute known and measurable under the facts presented.